

# DOCKET SECTION

## TABLE OF CONTENTS

Postal Rate and Fee Changes, 1997

Docket No. R97-1

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### TRIAL BRIEF OF THE NEWSPAPER ASSOCIATION OF AMERICA

February 10, 1998

Robert J. Brinkmann

NEWSPAPER ASSOCIATION OF AMERICA  
529 14th Street, N.W.  
Suite 440  
Washington, D.C.  
(202) 638-4792

William B. Baker  
Michael Yourshaw  
Alan R. Jenkins

WILEY, REIN & FIELDING  
1776 K Street, N.W.  
Washington, DC 20006-2304  
(202) 429-7000

## TABLE OF CONTENTS

I.	INTRODUCTION AND SUMMARY .....	3
A.	The Newspaper Association of America .....	3
B.	Statement of Interest & Recommendations .....	3
II.	THIS CASE PRESENTS THE COMMISSION WITH AN OPPORTUNITY TO RECOMMEND RATES MORE CONSISTENT WITH THE POSTAL SERVICE'S PUBLIC SERVICE MISSION.....	6
A.	The Postal Service Is First And Foremost A Public Service, Not A Competitor With Private Sector Services, And Its Rates Must Be Set In Light Of Its Special Status And Mission .....	6
B.	The Postal Service In This Case Continues To Offer Proposals That Are Inconsistent With Its Public Service Mission .....	9
III.	THE PROPOSED REDUCTION OF THE POUND RATE FOR STANDARD (A) ECR MAIL .....	10
IV.	INSTITUTIONAL COSTS.....	12
A.	First Class Mail Bears An Excessive Share Of The Institutional Costs Of The System.....	15
B.	The Commission Should Refine Its Assignment Of Institutional Cost In Recognition Of The Relative Mixes of Postal Functions Used By The Different Classes And Subclasses of Mail.....	16
C.	This Case Presents The Commission With Specific, Workable Proposals To Alleviate The Institutional Cost Burden On First Class Mail By Shifting Costs To Standard (A) Mail .....	20
V.	PRESORT DIFFERENTIALS IN ECR MAIL .....	22
VI.	CONCLUSION.....	24

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

**TRIAL BRIEF OF THE  
NEWSPAPER ASSOCIATION OF AMERICA  
February 10, 1998**

The Newspaper Association of America ("NAA"), by its attorneys, hereby respectfully submits its trial brief in this proceeding pursuant to the Presiding Officer's directive at Tr. 1/26-29 and Presiding Officer Ruling No. R97-1/4.

As did the Postal Service, NAA understands the Commission's purpose in soliciting trial briefs to be "an opportunity for the parties to summarize or outline their 'theory of the case.'"<sup>1</sup> As the Presiding Officer has explained, in its trial brief each party "should include an explanation of the theoretical and public policy considerations which it believes the Commission should give weight to."<sup>2</sup> Accordingly, NAA herein offers for the Commission's consideration what it believes to be the essential public policies that should govern this case and identifies specific actions that the Commission should take.

Fundamentally, NAA believes that the Postal Service has lost sight of its vital public service mission, and that it is now more concerned with gaining market share in "competitive markets" through leveraging its monopoly than with serving the American

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<sup>1</sup> USPS Trial Brief at 2. In addition to this trial brief, NAA expects to address these and other issues (including legal issues and rate design matters raised by intervenors) in its subsequent filings in this case.

<sup>2</sup> Tr. 1/27, *quoted by* USPS Trial Brief at 2.

public. The Postal Service's recent efforts to promote direct mail marketing<sup>3</sup> with federal government dollars which the USPS books as "institutional" costs show how far afield the institution has strayed.

In particular, consistent with the Act and these policy considerations, NAA believes that the Commission should:

1. Reject the Postal Service's proposed reduction of the pound rate for ECR Standard (A) Mail, and instead continue to set the pound rate in the established manner used most recently in Docket No. MC95-1;
2. Reduce the institutional cost contribution of First Class Mail, mindful of the public service mission of the Postal Service and the different mixes of postal functions used by the various subclasses; and
3. Reject the Postal Service's proposed creation of increased presortation discounts in Standard (A) ECR for high density and saturation mail.

Some of these points are addressed, as appropriate, in the testimony of witnesses sponsored by NAA. NAA is sponsoring the testimony of three witnesses:

1. Dr. James A. Clifton (ABA/NAA-T-1): In testimony co-sponsored with the American Bankers Association, Dr. Clifton proposes, on cost and equity grounds, to reduce to 12 cents the First Class extra ounce charge for the second and third ounces of workshared First Class Mail, and to recoup the revenue from Standard (A) mail.
2. Sharon Chown (NAA-T-1): Ms. Chown proposes that the Commission consider the mix of functions used by a given subclass of mail when determining institutional cost contributions and provides a system of measurement for doing so.
3. Michael Donlan (NAA-T-2): Mr. Donlan critiques the USPS's proposal to increase presortation discounts for Enhanced Carrier Route high density and saturation mail and recommends rejection of the proposed increases.

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<sup>3</sup> These efforts include such items as multimedia promotional kits. See Tr. 9/4703, 4783-4789 (USPS advertising mail promotional kit discussed in cross-examination of witness Takis).

With respect to other issues that we address in this brief, relevant evidence is found either in the cross-examination of the Postal Service's direct case, or in the testimony of witnesses sponsored by other parties.

## **I. INTRODUCTION AND SUMMARY**

### **A. The Newspaper Association of America**

NAA is a non-profit organization representing more than 1,600 newspapers in the United States and Canada. Most NAA members are daily newspapers, accounting for 87 percent of the daily circulation in the United States. More than 70 percent of NAA members are newspapers with circulations of less than 25,000. Most of these smaller newspapers serve less-densely populated rural and suburban communities in our nation. As such, NAA members have a strong interest that the federal government, in the form of the Postal Service, preserve its public service mission of providing universal service at equitable, non-discriminatory rates.

NAA members use all classes of mail and heavily use First Class, Periodicals, and Standard Mail.

### **B. Statement of Interest & Recommendations**

NAA's primary interest in this proceeding is in the rates to be recommended for Standard (A) Enhanced Carrier Route ("ECR") mail – in particular, the rates for saturation mailers which compete directly with newspapers for run-of-press ("ROP") advertising and preprint advertising.

Over the years, NAA member newspapers have seen the Postal Service move farther and farther away from its historic and statutory public service mission. Indeed, it has moved so far that little doubt can exist today that the Postal Service is deliberately

encouraging the shift of advertising dollars away from newspapers and into direct mail. The USPS consistently has acted more and more like a competitor to newspapers than as the competitively neutral public service that it is supposed to be. And it has done so despite the fact that a significant amount of the preprint advertising carried by newspapers' non-subscriber products is delivered by the Postal Service.

NAA members' concern has focused most directly on the rates charged by the Postal Service for saturation advertising mail distributed by their competitors, and on the USPS's recent public relations campaign to promote direct mail.<sup>4</sup> As for rates, NAA members have seen the Postal Service repeatedly propose either to reduce, or offer less than average rate increases, to saturation advertising mail. This type of advertising competes most directly with the advertising that supports the ability of newspapers to provide the reading public with news and other editorial information. These proposals take various forms, including: (1) outright rate reductions, (2) expanded discounts, (3) excessive allocations of institutional costs to captive First Class mailers, and (4) reducing the costs attributed to Standard Mail by manipulating costing methodologies.<sup>5</sup>

In this case, the Postal Service repeats this pattern once again. While asking for an overall revenue increase of billions of dollars, the USPS proposes a very modest increase for piece-rated ECR mail, and seeks *decreases* for pound-rated saturation mail. It proposes to expand, on sparse evidence, walk-sequencing discounts

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<sup>4</sup> There would be nothing wrong with the direct mail industry launching and financing a campaign to promote direct mail over newspapers. NAA's objection is to a *government agency* paying for a campaign designed to shift advertising dollars out of particular advertising media and into other advertising media.

in ECR mail. It once again would spare "competitive" services from having to make a reasonable contribution to institutional costs, instead saddling First Class mailers with an overwhelming share of the institutional costs of the system. Finally, the USPS proposes cost attribution methodologies that, in total, reduce the level of costs attributed to subclasses it deems "competitive."

NAA believes that these are the actions of a government agency that has lost sight of its basic public service mission. While this Commission does not have full regulatory powers over the Postal Service, it does have the authority and the duty to recommend rates that move in a direction that is more consistent with the Postal Service's historic public service mission.

Over the years, the Commission has stated on a number of occasions that it would prefer to reduce the institutional cost burden borne by First Class mail, and have what is now known as Standard (A) mail pay more of the institutional costs of the system, citing only concerns of rate shock as grounds for not doing so. The relatively small overall revenue increase sought in this case<sup>5</sup> presents this Commission with an opportunity to correct cost attributions and institutional cost assignments in a manner that will allow it to recommend rates more consistent with the Postal Service's statutory mission.

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<sup>5</sup> NAA shares some of the concerns expressed by OCA witness Smith and UPS witness Neels about mail processing costs.

<sup>6</sup> The Postal Service's cost management and long-standing automation program deserve appropriate credit for this, as they finally appear to be producing significant cost savings.

## **II. THIS CASE PRESENTS THE COMMISSION WITH AN OPPORTUNITY TO RECOMMEND RATES MORE CONSISTENT WITH THE POSTAL SERVICE'S PUBLIC SERVICE MISSION**

This case is governed by the public policies established by Congress in the Postal Reorganization Act. The most relevant provisions of the Act include Section 101(b), which establishes the overriding policy that the USPS is a public service, and the Section 3622(b) criteria that help the Commission implement this policy as it assigns institutional costs.

### **A. The Postal Service Is First And Foremost A Public Service, Not A Competitor With Private Sector Services, And Its Rates Must Be Set In Light Of Its Special Status And Mission**

The Postal Service is by law a public service provided by the federal government for its citizens. The Postal Service's attempt to become a more "market-driven" entity that deliberately tailors its rates and services in order to "compete" with private sector firms is fundamentally incompatible with its status as a government public service and inconsistent with the Postal Reorganization Act.

The Postal Reorganization Act of 1970 provides:

The United States Postal Service shall be operated as a basic and fundamental service provided to the people by the Government of the United States . . . . The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people.

39 U.S.C. § 101(a). To carry out this mission, Congress bestowed the Postal Service not only with unique privileges—including a legal monopoly over the delivery of letter mail, direct access to the federal Treasury, an exemption from taxes and business regulation generally—but also with vast assets that the Post Office Department had



accumulated for over two hundred years. These advantages were intended to enable the USPS to fulfill its universal service obligation.

NAA members believe that the Postal Service's rate proposals have, in recent years, reflected a loss of purpose and mission. Rather than focusing on providing a public service, the Postal Service has sought to reshape itself into a "competitive" entity even to the point of gloating about having put a private enterprise out of business.<sup>7</sup> As part of this effort, the Postal Service has made numerous proposals to lower the levels of costs allocated to "competitive" subclasses, to create new and larger discounts for mail categories which it believes are more open to "competition," and to place excessive institutional cost burdens on First Class mailers that are captive to the Private Express monopoly. This turns the Private Express Statutes on their head – their purpose is to protect universal service for the benefit of First Class mailers – not to serve as grounds for exploiting them.<sup>8</sup>

Examples of the Postal Service's loss of focus abound in other ways large and small. In recent years, the Postal Service has sponsored events and teams in Chinese and French bicycle races. The Postal Service now sells its own telephone cards and is testing debit cards. It has turned itself into a distributor of Christmas videos, T-shirts, jackets, and mugs.

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<sup>7</sup> See Bradstreet Testimony (AAPS-T-1) at 15 (quoting Postmaster General Runyon's remarks to NAPUS Leadership Conference regarding the demise of Publishers Express).

<sup>8</sup> This is also an important reason why Ramsey pricing should not be used in setting postal rates.

The Postal Service also is experimenting with electronic funds transfer and electronic payments and is considering entering that industry in a big way. It is today selling and distributing coupon inserts in its new movers package and is trying to establish "Deliver America" kiosks that can be used to bypass local retail stores and to order products directly from catalog companies. None of these activities have any direct relevance to the delivery of hard copy, and many of them could have a profound effect on private sector enterprises.

What is particularly troubling is that while the Postal Service has been engaging in these tangential activities, service has slipped considerably. For example, the testimony of National Newspaper Association witness Max Heath in this proceeding describes ways in which service for Periodicals mail has suffered in recent years. See NNA-T-1.

An especially galling (to newspapers) example of the Postal Service's loss of mission is its launch of an extensive public relations campaign promoting direct mail. The testimony of Association of Alternate Postal Systems ("AAPS") witness Kenneth Bradstreet (AAPS-T-1) described certain examples of this campaign. It is particularly troubling that the USPS accounts for those expenses as *institutional* costs.<sup>9</sup> For example, the Postal Service has spent substantial sums delivering "Direct Mail *delivers*", a kit promoting direct mail, to thousands of businesses across the country, hoping to "shed new light on the power of Direct Mail as a marketing tool." Included in

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<sup>9</sup> See n.3.

that campaign is the delivery of a *free copy*<sup>10</sup> of a specially-produced hardback book, *Being Direct* by Lester Wunderman, which has a retail price of \$25.00. Again, the problem is not with the book itself, but that the book is being distributed at government expense by a government agency that is supposed to be serving the general public.

Although the Commission has, to its credit, properly tempered some of the USPS's most egregious attempts to place even *more* costs on First Class mailers,<sup>11</sup> the Postal Service continues to advance proposals that favor its competitive interests at the expense of rates which more properly embody its public service mission. NAA respectfully submits that in recommending rates in this proceeding, the Commission should place paramount importance on the Postal Service's public service mission, rather than its "competitive" aspirations.

**B. The Postal Service In This Case Continues To Offer Proposals That Are Inconsistent With Its Public Service Mission**

Unfortunately, the Postal Service's proposals in this case continue down the same misguided path. Once again, the Postal Service is proposing rate reductions for selected categories of mail to further its competitive self-interest, while reducing cost attributions and placing a disproportionate share of the institutional cost burden on First Class mailers. Prominent examples include the proposed reduction in the pound rate

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<sup>10</sup> The book, whose \$25.00 price shows on its dust cover, arrives complete with a inscription by Mr. Wunderman on the page preceding the title page, over the printed line "Compliments of the United States Postal Service."

<sup>11</sup> *Opinion and Recommended Decision*, Docket No. R87-1 at ¶ 4148; *see also* *Opinion and Recommended Decision*, Docket No. R90-1 at IV-33, n.16 (*R94-1 Op.*); *see also* *Change in Service, 1989: First-Class Delivery Standards Realignment*, Docket No. N89-1 (July 25, 1990) (Advisory Opinion).

for ECR mail (which the testimony of saturation mailers themselves indicate is the most competitively significant part of ECR rates today)<sup>12</sup> and the proposed assignment of the great majority of institutional costs to First Class mail.<sup>13</sup> A related concern is the Postal Service's apparent eagerness consistently to propose rate reductions in "competitive" mail categories on the basis of the slimmest of evidence.<sup>14</sup> This contrasts with its steadfast neglect of long-suffering captive mailers despite overwhelming grounds for believing that, for example, First Class extra ounce rates are grossly excessive.

Enough is enough. The time has come for the Commission to recommend rates that reflect the Postal Service's public service mission, not its self-created competitive interests. The sections that follow, as well as NAA's future submissions, elaborate on certain key decisions that the Commission must make.

### **III. THE PROPOSED REDUCTION OF THE POUND RATE FOR STANDARD (A) ECR MAIL**

As mentioned above, to NAA members the most important proposal in this case is the Postal Service's requested drastic reduction in the pound rate for ECR mail. NAA urges the Commission to reject this proposed reduction as unjustified and unwarranted.

In past cases, the Commission has determined the pound rate according to a formula which uses known inputs such as the breakpoint and the piece rate to calculate

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<sup>12</sup> See Testimony of Harry Buckel (SAC-T-1) and Testimony of Godfred Otuteye (AISOP-T-1).

<sup>13</sup> The marginal narrowing of the relative markups of First Class and Standard (A) mail as measured by the so-called cost coverage index (see Testimony of Dr. Donald O'Hara (USPS-T-1) at 16-20) does nothing to correct the basic problem.

<sup>14</sup> Examples include the proposed Standard (A) ECR pound rate and certain presortation discounts in ECR mail.

a pound rate. *See Opinion and Recommended Decision*, Docket No. MC95-1 at V-254, ¶ 5642. Although the Postal Service's ECR rate design witness, Mr. Moeller, uses this formula, he significantly modifies its application by "selecting" arbitrarily – rather than measuring or calculating – the pound rate. Mr. Moeller opted for this approach in large part on the basis of a cost analysis that now appears in the record as Exhibit USPS-ST-44B (LR-H-182). NAA submits that Mr. Moeller's approach is inferior to the Commission's use of the formula and should be rejected.

The testimony of Kenneth Bradstreet (AAPS-T-1) discusses at length the public policy considerations at issue. Mr. Bradstreet traces the history of the Postal Service's generosity towards saturation mailers. He urges the Commission to maintain current *rate relationships and not lower Standard ECR pound rates any further*. He notes that, consistent with Section 3622(b)(4) of the Act, which requires the Commission to consider the effect of postal rate changes on private competitors, the survival of independent delivery companies depends upon the Commission restraining the Postal Service's misuse of the latter's letter monopoly. While the AAPS represents the *interests of the private delivery industry, and not newspapers*, NAA generally endorses Mr. Bradstreet's testimony.

Mr. Bradstreet's testimony is consistent with the companion testimony of Mr. Green (AAPS-T-2). Mr. Green provides further evidence that the artificially low rates the USPS seeks to charge for competitive products and services, including the *pound rate, threaten small delivery businesses*. Together, the testimony of Mr. Bradstreet and Mr. Green address the public policy issues at stake, as well as other aspects of the pound rate proposal.

In addition, NAA notes that some, but not necessarily all, of the flaws in the cost analysis presented in LR-H-182 (now in the record as Exhibit USPS-ST44-B) are summarized in an appendix to the testimony of Val Pak/Carol Wright witness Dr. John Haldi (VP/CW-T-1). Dr. Haldi points out that the analysis is based on insufficient data and does not properly adjust for presortation and dropshipping differences.

That the proposed reduction in the pound rate is competitively motivated is amply demonstrated not only by the Postal Service's own testimony<sup>15</sup> but also by the testimony of Mr. Buckel (SAC-T-1) and Mr. Otuteye (AISOP-T-1) on behalf of saturation mailers. Mr. Buckel and Mr. Otuteye each provide descriptive testimony that argue in support of the Postal Service's reduced ECR pound rate for saturation mail, the category of mail that they principally use. However, they provide no independent cost or economic analysis for the rate reduction.

In Docket No. MC95-1, the Commission properly rejected a proposal to reduce the pound rate. It should do so again.

#### **IV. INSTITUTIONAL COSTS**

For many years, the Postal Service has assigned a disproportionate share of institutional costs to First Class Mail, which is captive to the postal statutory monopoly. These assignments have been disproportionate whether stated in terms of (1) absolute dollars, (2) relative percentage of revenues compared to percentages of volume or weight, or (3) unit (per-piece) contributions in cents per piece.<sup>16</sup> Although the

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<sup>15</sup> See Tr. 6/2996 (Moeller) (conceding competitive motivation).

<sup>16</sup> The testimony of Dr. James A. Clifton, co-sponsored by the American Bankers Association and NAA (ABA/NAA-T-1), discusses this phenomenon. The same  
(Continued...)

Commission, to its credit, often has moderated the USPS's proposed assignments, the net result is that advertising mail generally, and ECR mail in particular, accounts for a substantially smaller share of both revenue and institutional cost contributions than its proportion of volume or weight. This misallocation of institutional costs harms the very mailers the postal monopoly is supposed to protect and has competitive consequences.

To address this critical problem, the assignment of institutional or "common" costs must be guided by the overarching public service mission of the Postal Service. The assignment of institutional costs is a *policy* decision – it is not dictated by economic theory. Therefore, the ultimate reference point for the assignment of these "institutional" costs is whether the assignment promotes the public service mission of the Postal Service. Congress has defined the mission of the Postal Service, and it is the task of the Postal Rate Commission to ensure that cost allocations and the resulting postal rates promote and do not impede that mission.

As described above, the Postal Service has wandered afar from its public service mission, and the institutional cost allocations in place today cannot help but reflect that fact. Starting with this case, the Commission should begin to set institutional cost assignments (and the resulting postal rates) with a renewed and bold focus on the USPS's public service mission, rather than merely tinkering with allocations made in the past. The first and most important step is to announce in this proceeding that

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(...Continued)

phenomenon receives attention in the testimony of Dr. Clifton's companion testimony on behalf of ABA/EEI/NAPM, and Major Mailers Association witness Richard Bentley (MMA-T-1). Similarly, the testimony of AAPS witness Kenneth Bradstreet discusses this pricing behavior from the perspective of a competitor.

institutional cost assignments will no longer be used as a means of promoting the alleged "competitive" interest of the Postal Service by burdening First Class ratepayers. The second step is to adjust the relative institutional cost burdens to begin relieving First Class mailers of their unfair and undue burden.

Furthermore, NAA believes that substantial changes are necessary in the manner by which the institutional costs of the system are assigned. The current approach was created at a time when barcoding and worksharing were rare or unknown. Despite enormous changes in postal operations, the appropriateness of the traditional assignment system has never been revisited. The current system is out of date, places far too much of the burden on First Class mailers, and does not adequately reflect the mix of postal functions actually used by the different subclasses. Moreover, it allows heavily workshared subclasses to avoid paying their fair share of the costs of the delivery function.

Aspects of these matters are explored in the testimony of NAA witness Sharon Chown (NAA-T-1) and in testimony of Dr. James A. Clifton that NAA is co-sponsoring with the American Bankers Association (ABA/NAA-T-1). Both witnesses critique the underlying analytical approach to assigning institutional costs. Dr. Clifton also takes issue with the institutional cost assignments used by USPS witness O'Hara. At the same time, the Chown and Clifton testimonies are generally consistent with and complementary to Dr. Clifton's companion testimony (ABA/EEI/NAPM-T-1) and the basic thrust of the testimony of Mr. Bentley (MMA-T-1).



### **A. First Class Mail Bears An Excessive Share Of The Institutional Costs Of The System**

Currently, First Class rates recover a share of institutional costs of the system that greatly exceeds First Class mail's proportion of the total volume, the total attributable costs, or the total weight of the mailstream. First Class mail also makes about twice the contribution, in cents per piece, of Standard (A) letters which receive similar handling and processing.

The Commission has repeatedly stated that it wants to bring the contributions of First Class Mail and advertising mail closer together.<sup>17</sup> For example, in Docket No. R90-1, the Commission found that "we do not consider it to be consistent with the Act to shift an excessive proportion of the institutional cost burden onto First-Class (or any other) mailers."<sup>18</sup>

In this case, USPS witness O'Hara has proposed cost coverages that essentially perpetuate the current imbalance.<sup>19</sup> Witness Bentley, appearing on behalf of the Major Mailers Association, provides, as Figure 1 of his testimony, a chart which presents the following comparisons using the USPS's proposed rates:

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<sup>17</sup> NAA notes that Mr. Bentley's testimony contains an illuminating review and discussion of the Commission's past statements in this regard. See MMA-T-1 at 5.

<sup>18</sup> *Opinion and Recommended Decision*, Docket No. R90-1 at IV-34, ¶¶ 4107; see also *Opinion and Recommended Decision*, Docket No. R94-1 at IV-15, ¶¶ 4040-41 (R94-1 Op.); *Opinion and Recommended Decision*, Docket No. R87-1 at 367 (R87-1 Op.).

<sup>19</sup> Dr. O'Hara compounds the problem by proposing to apply the "markup" to only volume variable costs, rather than total attributable costs. USPS-T-30 at 13-14. This is contrary to Commission precedent and should be rejected. This issue is addressed by UPS witness Henderson (see UPS-T-3 at 7-12). As NAA believes that this matter involves purely an issue of law, it will address this issue in its post-hearing brief.

	<u>First Class</u>	<u>Standard (A)</u>
Percentage of total volume	49	34
Percentage of total weight	17	69
Percentage of total revenues	55	20
Percentage of total inst. costs	61	21

Under the Postal Service's proposed rates, First Class mail would make an average unit contribution per piece of 17.5 cents. In comparison, Standard (A) ECR mail would make an average unit contribution of 7.9 cents per piece. This gap between unit contributions has increased steadily over the past 15 years. It should be reduced.

NAA respectfully submits that the USPS's proposed distribution of the institutional costs is contrary to the policy of the Act. It also believes that a source of the problem is the continued reliance on an outmoded method of assigning institutional costs.

As for the latter, NAA submits that the Commission should refine its institutional cost analyses in the manner proposed by NAA witness Chown and also give greater weight to unit cost contributions. These concepts are discussed in subpart B, *infra*.

In addition to these improved analytical tools, NAA and several other intervenors have submitted specific, modest, and achievable proposals to improve the distribution of the overhead costs in a manner more consistent with the Commission's expressed desires and, we believe, the Act itself. These are discussed in subpart C, *infra*.

**B. The Commission Should Refine Its Assignment Of Institutional Cost In Recognition Of The Relative Mixes of Postal Functions Used By The Different Classes And Subclasses of Mail**

Since Reorganization, the principal measure of institutional cost assignments under 39 U.S.C. § 3622(b)(3) has been a comparison of a subclass's revenues to its

total attributable costs.<sup>20</sup> NAA submits that while this method perhaps was a useful way to compare institutional cost contributions in the era before the widespread use of barcoding and worksharing discounts, it now is outmoded, inadvertently skews institutional cost contributions in a manner harmful to First Class mailers, and should be revamped.

The Commission has already recognized, and addressed, one problem arising from the continued use of cost coverages in today's environment – the notion that highly discounted rate categories pay superficially high “implicit” markups. See *MC95-1 Op.* at III-28-29, ¶¶ 3071-73. The Commission has properly dismissed that line of argument as meritless, noting that a subclass's avoidance of attributable costs due to worksharing should not allow it to avoid institutional costs. However, the principle that a subclass's worksharing should not allow it to reduce its institutional cost contribution applies as well to the very method by which institutional cost contributions are assigned.

In her testimony (NAA-T-1), Ms. Chown explains how the current overall markup and cost coverages approach originated in an era when the rate schedules contained few, if any, discounts. The far greater complexity of today's rate schedules, however, makes comparisons more difficult and the past reliance on cost coverages less useful. This is because, as Ms. Chown shows, the distribution of institutional costs across the different postal functions (mail processing, transportation, window service, and delivery)

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<sup>20</sup> The percentage by which rates exceed attributable costs is known as a “markup”; the ratio of a subclass's revenues to its costs is known as a cost coverage; and the “markup” of a subclass relative to the systemwide average is called the “markup index.”

differs significantly from the distribution of attributable costs. This is due to differences in the percentages of costs that are attributed in each of the cost segments.

Ms. Chown explains how the discrepancies between (1) the different mix of postal functions used by the various subclasses of mail and (2) the distribution of attributable costs present a problem when assigning institutional costs in the current manner.<sup>21</sup> Marking up total attributable costs (as is now done) enables a subclass that reduces its mail processing attributable costs by presorting *also* to receive a reduced assignment of *all* institutional costs, not merely those associated with the mail processing function.<sup>22</sup> Thus, mail subclasses that primarily use mail functions for which relatively few costs are attributed receive a low institutional cost assignment, even though they may make heavy use of functions which contain substantial institutional costs.<sup>23</sup>

For example, because Standard (A) ECR mail is heavily presorted and dropshipped, its costs are predominately delivery costs. Delivery costs are

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<sup>21</sup> As Ms. Chown explains in her testimony (NAA-T-1 at 4, lines 17-19), "Applying a markup to total attributable costs is appropriate *only if* (1) all mailers buy approximately the same mix of the four basic functions *or* (2) the ratio of institutional costs to attributable costs is relatively constant across all four functions." Neither necessary assumption is true in today's postal system.

<sup>22</sup> Although institutional costs are not *causally related* to any particular subclass, many of these costs indisputably arise from the provision of a particular function of the Postal Service. Currently, however, the Postal Service applies a markup or cost coverage to total subclass costs without regard to the mix of postal functions actually used by those subclasses.

<sup>23</sup> Conversely, subclasses that make greater use of postal functions with relatively high attributable costs are assigned a greater share of institutional cost, even though these same functions cause the Postal Service to incur a relatively low amount of institutional cost.

predominantly institutional costs, since less than 30 percent are attributed. The measure (or metric) used to set ECR mail's contribution to the recovery of the more than 70 percent of delivery costs that are institutional is its institutional cost markup. Yet, when ECR mailers dropship and presort, which reduce their attributable costs in functions *other than delivery*, the current process allows them *also* to reduce their contribution to the institutional costs of delivery. This is not sound.

In other words, under the current approach, worksharing in other functions (mail processing, transportation) allows ECR mailers to escape paying for institutional costs incurred in the delivery function. This is perverse because their dropshipping and presortation do nothing to reduce delivery costs.

To correct for this aberration, Ms. Chown proposes an improved method that reflects the fact that the four basic postal functions are attributed in different proportions. In particular, Ms. Chown proposes to weight the attributable cost of each postal function by a factor equal to that function's percentage of total institutional cost divided by its percentage of total attributable cost. The Commission would use the resulting "weighted attributable cost," instead of the unweighted attributable costs now used, as the basis on which it judgmentally determines (in the same manner as now) the institutional cost contribution to be collected from the subclass. As today, the resulting dollar contribution would then be added to the traditional attributable cost base to arrive at the subclass's target revenue.<sup>24</sup>

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<sup>24</sup> This weighting would be used only in assigning institutional costs; it would not affect the projected attributable costs of a subclass.

This would differ from the current approach only in one respect: institutional cost contributions would be evaluated on the basis of weighted attributable costs rather than the unweighted attributable costs now used.<sup>25</sup> NAA believes that this refinement would address the problems inherent in the current method, and also, we believe, the question asked earlier in this proceeding by the Presiding Officer. See Tr. 7/3151-52 (Moeller).

Ms. Chown's testimony provides a new starting point for the Commission to use in applying its judgment. She does not propose any specific institutional cost assignments. Nor does she propose adding to or subtracting from the current attributable costs of any subclass. However, Ms. Chown's analysis is complementary to the testimony of ABA/NAA witness Dr. James Clifton, as well as others, who suggest proposals to reduce the institutional cost burden borne by First Class mail.

**C. This Case Presents The Commission With Specific, Workable Proposals To Alleviate The Institutional Cost Burden On First Class Mail By Shifting Costs To Standard (A) Mail**

In this case, NAA, through the testimony of Dr. Clifton jointly sponsored by the American Bankers Association, has proposed a realistic, timely, and achievable reduction in the institutional cost burden of First Class mail. In particular, Dr. Clifton proposes to reduce the extra ounce rate for the second and third ounces of workshared First Class mail to 12 cents, from the 23 cents now in effect, and to shift the institutional costs currently recovered through the higher charge to Standard (A) mail. This is a very

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<sup>25</sup> Ms. Chown's method would not change the dollar amount of costs attributed to a subclass. Instead, it simply recognizes that each dollar of attributable costs should not be given the same weight when assigning institutional costs

modest proposal, in that a significant rate disparity between the two classes of workshared mail would still remain,<sup>26</sup> but at least it is a step in the right direction and is in line with the Commission's preference for moderate rate design changes. In order to maintain revenue neutrality, Dr. Clifton also proposes to increase of the cost coverage of Standard (A) mail. If these revenues were recovered from all Standard (A) commercial mail evenly, the overall rates for Standard (A) mail would rise by about 0.4 cents per piece.

Dr. Clifton's testimony presents the cost and equity rationales for what is, on balance, a conservative proposal. Dr. Clifton notes that his proposal is limited to workshared mail, although the Commission reasonably could extend some reduction to single piece extra ounce rates as well. Dr. Clifton also notes that his testimony would narrow the difference in unit contribution paid by similar letter mail in the First Class and Standard (A) classes.

The Commission has received at least two other reasonable proposals for reducing the cross-subsidy between Standard (A) mail and First Class mail. Dr. Clifton, on behalf of the ABA, EEI and NAPM, presents a companion proposal to increase the discounts for First Class workshared mail. Dr. Clifton testifies that this increase in discounts is justified because the test year mail processing and delivery costs for workshared First Class mail are lower than those proposed by the Postal Service, which failed to incorporate several cost reducing factors stemming from reclassification into its roll-forward model.

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<sup>26</sup> The cost coverage for the second and third ounce of workshared First Class mail, while reduced, would still be a very high 480 percent. ABA/NAA-T-1 at 13.

In addition, MMA witness Bentley suggests that the Commission should consider retaining the current 32 cent rate for the First Class stamp. MMA-T-1 at 10-11.

Alternatively, Mr. Bentley suggests that the Commission reduce the rate charged for the first extra ounce of First Class mail (a suggestion both broader and possibly smaller than Dr. Clifton's).

The testimony of Dr. Clifton (ABA/NAA-T-1), as well as his companion testimony, and those of Mr. Bentley and Mr. Bradstreet, take issue with the assignment of institutional costs proposed by USPS witness O'Hara. Dr. Clifton's testimony conflicts with the testimony of witnesses such as Dr. John Haldi (VP/CW-T-1), Harry Buckel (SAC-T-1) and Godfred Otuteye (AISOP-T-1), who generally support the Postal Service's institutional cost allocations.

## **V. PRESORT DIFFERENTIALS IN ECR MAIL**

Part of the Commission's responsibility in recommending rates in a spirit consistent with the public service nature of the Postal Service is not to recommend new or increased rate discounts, especially in "competitive" rate categories, in the absence of reliable data. This caution applies, for instance, to the Postal Service's proposal for increased presortation discounts for ECR saturation and high density mail.

As the testimony of NAA witness Michael Donlan (NAA-T-2) points out, the Postal Service does not have a reliable cost basis for increasing the presortation discounts in this case in the manner proposed. Therefore, he recommends that the Commission maintain the current discounts for commercial ECR mail.

Until this case, mail processing costs were considered the same for the basic, high density and saturation ECR presort tiers. Accordingly, the differences between the



saturation, high-density, and basic tiers have been based on differences in delivery costs. In this proceeding, Mr. Moeller proposes to base ECR presort discounts upon erroneous differences between walk-sequenced mail (by which he means saturation and high density) and non-walk-sequenced mail (basic tier, despite USPS requirements that this be at least line of travel sequenced) in both the mail processing and delivery functions. This results in a higher percentage rate increase for basic ECR mail than for high density or saturation ECR mail.<sup>27</sup> He uses cost estimates provided by USPS witness Daniel, which ultimately are based on cost estimates from Mr. McGrane (USPS-ST-44A) of the purported cost differences between walk-sequenced and non-walk-sequenced mail.<sup>28</sup>

As Mr. Donlan explains, the problem with the Postal Service's proposal is that it relies upon mostly pre-reclassification data to set post-reclassification discounts. It is unlikely that pre-reclassification data accurately reflect the current post-reclassification operating environment. Mr. Donlan points out that the great majority of the data (10 1/2 accounting periods of the 13 AP's) used in Mr. McGrane's analysis consists of information collected prior to the July 1, 1996, implementation of reclassification changes.<sup>29</sup> As evidence, he notes that the cost difference between walk-sequenced

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<sup>27</sup> These disparities result from the proposed increases in presort *discounts* for high density and saturation mailers. ECR high density letter and saturation letter discounts receive the largest percentage increases (162.5 percent and 76.5 percent, respectively).

<sup>28</sup> Mr. McGrane separated mail processing costs for Standard (A) ECR mail into costs for walk-sequenced and non walk-sequenced mail on the basis of In-Office Costing System ("IOCS") direct tallies for ECR mail. See Exhibit USPS-44A.

<sup>29</sup> Over 80 percent of the data relied on by witness McGrane was collected prior to reclassification implementation. See NAA-T-2 at 9; Tr. 15/7666.

and non walk-sequenced non-letters has decreased by nearly 33 percent following reclassification (0.7 cents per piece). Yet even this relatively meager post-reclassification data is not a sufficient basis for substantially increasing discounts.

Mr. Donlan also observes that the Postal Service's commercial ECR letter presort discounts are based on a methodology that accounts for increases in mail processing costs related to delivery point sequencing ("DPS"), but fails to account for DPS-related delivery cost savings. He points out that while Mr. McGrane includes the additional mail processing costs incurred in delivery point sequencing of ECR basic letters, no Postal Service witness makes an offsetting adjustment in delivery costs to account for the associated savings in carrier in-office costs from the same delivery point sequencing of ECR basic letters. By ignoring offsetting delivery cost savings for DPS letters, NAA believes that the Postal Service cost estimates overstate the actual difference between basic and high-density/saturation letter mail.

For these reasons, Mr. Donlan explains that the proposed increases in ECR presort discounts are not justified, and the Commission should recommend maintaining the current discounts.

## **VI. CONCLUSION**

The Newspaper Association of America respectfully submits this trial brief to summarize the public policy issues relevant to this case, and to explain how the testimony of witnesses sponsored by NAA and other parties relate to these policies. NAA urges the Commission (1) to recommend rates mindful of the overarching public service mission of the Postal Service, (2) to reject the unjustified and competitively motivated reduction in the pound rate, (3) to improve the institutional cost assignments

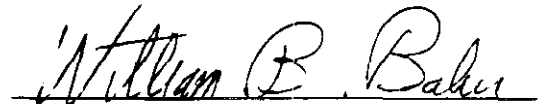
by using a measure of costs appropriate for today's worksharing environment and by relieving the burden on First Class mail, and (4) to reject the flawed increase in ECR presort discounts.

Respectfully submitted,

NEWSPAPER ASSOCIATION OF AMERICA

Robert J. Brinkmann  
NEWSPAPER ASSOCIATION OF AMERICA  
529 14th Street, N.W.  
Suite 440  
Washington, D.C.  
(202) 638-4792

By:



William B. Baker  
Michael Yourshaw  
Alan R. Jenkins

WILEY, REIN & FIELDING  
1776 K Street, N.W.  
Washington, DC 20006-2304  
(202) 429-7000

### CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

February 10, 1998

  
William B. Baker